

Auditing Procedures Report

Issued under P.A. 2 of 1968, as amended.

Local Government Type <input checked="" type="checkbox"/> City <input type="checkbox"/> Township <input type="checkbox"/> Village <input type="checkbox"/> Other		Local Government Name City of Grayling	County Crawford
Audit Date 6/30/05	Opinion Date 10/13/05	Date Accountant Report Submitted to State: 12/23/05	

We have audited the financial statements of this local unit of government and rendered an opinion on financial statements prepared in accordance with the Statements of the Governmental Accounting Standards Board (GASB) and the *Uniform Reporting Format for Financial Statements for Counties and Local Units of Government in Michigan* by the Michigan Department of Treasury.

We affirm that:

1. We have complied with the *Bulletin for the Audits of Local Units of Government in Michigan* as revised.
2. We are certified public accountants registered to practice in Michigan.

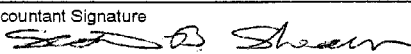
We further affirm the following. "Yes" responses have been disclosed in the financial statements, including the notes, or in the report of comments and recommendations

You must check the applicable box for each item below.

- | | |
|---|---|
| <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | 1. Certain component units/funds/agencies of the local unit are excluded from the financial statements. |
| <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | 2. There are accumulated deficits in one or more of this unit's unreserved fund balances/retained earnings (P.A. 275 of 1980). |
| <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | 3. There are instances of non-compliance with the Uniform Accounting and Budgeting Act (P.A. 2 of 1968, as amended). |
| <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | 4. The local unit has violated the conditions of either an order issued under the Municipal Finance Act or its requirements, or an order issued under the Emergency Municipal Loan Act. |
| <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | 5. The local unit holds deposits/investments which do not comply with statutory requirements. (P.A. 20 of 1943, as amended [MCL 129.91], or P.A. 55 of 1982, as amended [MCL 38.1132]). |
| <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | 6. The local unit has been delinquent in distributing tax revenues that were collected for another taxing unit. |
| <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | 7. The local unit has violated the Constitutional requirement (Article 9, Section 24) to fund current year earned pension benefits (normal costs) in the current year. If the plan is more than 100% funded and the overfunding credits are more than the normal cost requirement, no contributions are due (paid during the year). |
| <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | 8. The local unit uses credit cards and has not adopted an applicable policy as required by P.A. 266 of 1995 (MCL 129.241). |
| <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | 9. The local unit has not adopted an investment policy as required by P.A. 196 of 1997 (MCL 129.95). |

We have enclosed the following:

	Enclosed	To Be Forwarded	Not Required
The letter of comments and recommendations.			✓
Reports on individual federal financial assistance programs (program audits).			✓
Single Audit Reports (ASLGU).	✓		

Certified Public Accountant (Firm Name) Hill-Schroderus & Co. LLP			
Street Address 923 Spring Street	City Petoskey	State MI	ZIP 49770
Accountant Signature  CPA		Date 12/23/05	

**FINANCIAL REPORT
CITY OF GRAYLING
JUNE 30, 2005**

**CITY OF GRAYLING
FINANCIAL REPORT
JUNE 30, 2005**

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October 13, 2005

Independent Auditors' Report

Honorable Mayor, Members of
City Council and City Manager
City of Grayling, Michigan

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Grayling, Michigan, as of and for the year ended June 30, 2005, which collectively comprise the City of Grayling's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the City of Grayling's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Grayling, as of June 30, 2005, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 13, 2005, on our consideration of the City of Grayling's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

City of Grayling
Grayling, Michigan

The management's discussion and analysis and the budgetary comparison information are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City of Grayling's basic financial statements. The other supplemental information as listed in the table of contents is presented for purposes of additional analysis and is not a required part of the basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is also not a required part of the basic financial statements of the City of Grayling. The other supplemental information and the schedule of expenditures of federal awards have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Hill, Schroeder & Co.

CERTIFIED PUBLIC ACCOUNTANTS
Petoskey, Michigan

CITY OF GRAYLING
P.O. BOX 549
GRAYLING, MI 49738

MANAGEMENT'S DISCUSSION AND ANALYSIS

This section of the CITY OF GRAYLING (the City) annual financial report presents our discussion and analysis of the entity's financial performance during the fiscal year ending June 30, 2005.

FINANCIAL HIGHLIGHTS:

Our financial status remained stable over the last year. Ending net assets for the Governmental Funds total \$7,945,361 during this fiscal year, which reflects an increase of \$326,054.

Overall revenues for Governmental Funds were \$3,060,055, a 57% increase over the prior year. Overall expenses were \$2,992,687. In addition, we booked interfund transfers of (\$475,789) and sale of property of \$59,085, which reflected an excess expense of \$349,336.

In 1994, the people of Michigan approved Proposal A. The change to the state's tax structure created an assessed value and a taxable value for each parcel. The taxable value, or SEV, is 50% of the true cash value of a piece of land and its improvements. That value continues to rise as the value of property increases. The increase in taxable value is capped at the CPI or 5%, whichever is smaller, as long as the owner does not sell the property. Upon a sale, the property is reassessed and the new taxable value will be the same as the assessed value.

Property taxes are based on the taxable value not the assessed value. If there are no sales or improvements in the City, the property tax revenue will only increase by the CPI. Most townships are experiencing a much greater growth in their property tax revenue, due to the fact new development is taking place in rural communities rather than cities.

Including IFT's our 2004 taxable value increased by 6.18% during the last year, from \$49,305,173 to \$52,401,189. Assessed Value only increased 4.68%, from \$63,224,300 to \$66,185,423. A notable taxable increase would seem to indicate increased sales. However, we are aware of several uncappings that were never made by previous assessors. This could distort the percentage of annual increase.

OVERVIEW OF THE FINANCIAL STATEMENTS:

This annual report consists of three parts: management's discussion and analysis, the basic financial statements and other supplementary information. The basic financial statements include two different types of statements that present different views of the entity.

The first two statements are entity-wide financial statements and provide both long and short-term information about our overall financial status. These statements present governmental activities and/or business-type activities.

The remaining statements are fund financial statements which focus on individual parts of the entity in more detail.

The notes to the financial statements explain some of the information in the statements and provide more detailed data.

The supplemental information further explains and supports the financial statement information.

ENTITY-WIDE STATEMENTS:

The entity-wide statements report information about the entity as a whole using accounting methods used by private companies. The Statement of Net Assets includes all of the entity's assets and liabilities. The Statement of Activities records all of the current year revenues and expenses, regardless of when received or paid.

The two entity-wide statements report net assets and how they have changed. Net assets are the difference between the entity's assets and liabilities. This is one method to measure the entity's financial health or position. Over time, increases and decreases in the entity's net assets are an indicator of whether financial position is improving or deteriorating.

To assess overall health of the entity you may also have to consider additional factors such as tax base changes, facility conditions and personnel changes.

FUND FINANCIAL STATEMENTS:

The fund financial statements provide more detailed information about the entity's funds, focusing on significant (major) funds and not the entity as a whole. Funds are used to account for specific activities or funding sources. Some funds are required by law or bond covenants. They also may be created by the entity's board. Funds are established to account for funding and spending of specific financial resources and to show proper expenditure of those resources.

The entity has the following types of funds:

GOVERNMENTAL FUNDS - Most of the entity's activities are included in the governmental fund category. These funds are presented on the modified accrual basis, which is designed to show short-term financial information. You will note that differences between the entity-wide statements and the fund statements are disclosed to explain the differences between them.

PROPRIETARY FUNDS - These funds represent activities in the government which are basically treated like private sector companies. These funds are designed to have revenues earned adequate to pay for the operations of the activity. These funds are presented on a full accrual method and will show little difference from the entity-wide statement presentation.

FIDUCIARY FUNDS - The entity is a trustee or fiduciary for assets that belong to others. The entity maintains these funds and is responsible for ensuring that the assets of these activities are spent for their intended purpose and at the direction of those to whom the funds belong. These activities do not appear in the entity-wide financial statements since the assets do not belong to the entity.

FINANCIAL ANALYSIS OF THE ENTITY'S FUNDS:

101 General Fund

The General Fund is the City's main bank account. It collects all money that the law does not require to be accounted for in a separate fund. It also pays all the bills that do not fall within another fund. The General Fund covers the widest range of activities in any city. In Grayling, it pays for all city services except streets, equipment, water and sewer.

Capital projects included:

Park Project	\$ 37,515	In Progress
New Fire Truck & Equipment	570,244	Completed
Ice Rink Paving	26,505	Completed
Cemetery Expansion	9,832	In Progress
New Police Car	30,032	Completed

We received FEMA Grant funds in the amount of \$484,492. Crawford County contributed \$37,640 for purchase of an air compressor, and the Rotary Club of Grayling donated \$3,180 for the purchase of a rescue sled. Weyerhaeuser donated \$1,000 for the Ice Rink.

Wages were increased by 3% for all nonunion employees. All union employee wages increased according to their contracts. Fringe benefits and payroll taxes have increased accordingly. BCBS continued to increase, up 19.17%. MERS costs have increased due to the aging of our long term employees and the retirement of one DPW worker. We also increased our personnel with the addition of one full-time fireman.

Expenditures were allocated as follows:

Culture and Recreation	\$ 84,197
General Government	548,697
Legislative	20,483
Public Safety	608,543
Public works	138,586

203 Major Streets & 203 Local Streets

The State of Michigan classifies all city streets as Major and Local Streets. The classification is based on criteria that include width, parking restrictions, connections to state trunk lines and traffic count. Major streets are eligible for increased funding from the state. This year we received PA 51 Funds of \$102,428 for major streets and \$56,195 for local streets. The revenue for these classifications must be kept in separate funds. The street funds receive money from the state that is raised from gasoline taxes. This money must be used for construction and maintenance of city streets.

This state money does not cover the cost of streets for any city. Each year, money is transferred from the General Fund to pay for the cost of maintenance and snow removal; we anticipate this transfer next year as well

The major streets in the City include:

- Industrial Drive*
- Hanson*
- Dupont*
- Salling*
- Lake*
- Maple*
- State*
- Michigan*
- Peninsular*
- Norway*
- One block of Ionia from Cedar to Peninsular*

All other city streets are classified as local streets.

211 Income Tax

The Income Tax Fund collects the revenue from the city Income Tax. In 1972, the voters approved the ordinance, which limited expenditures from the fund to street and storm sewer construction. This is a 1% tax on income of city residents and ½ % on the income others earn in the city. It is important that the Income Tax Fund always has sufficient money to pay for necessary street and sidewalk improvements, which was the original intent of the ordinance that the residents approved. City Council adopted the policy establishing a minimum amount of \$250,000, to retain in the Income Tax Fund for such needed improvements.

The current fund balance is \$852,216. The 2005-2006 anticipated capital projects include the completion of the Streetscape project, completion of the Park Improvements, Stormwater improvements, and completion of the Lawndale Fulton project. Designated funds amount to \$408,607, leaving an undesignated balance of \$443,609.

Revenues increased as anticipated due to diligent enforcement and consistent disbursement of information to our residents and business owners. The addition of a full-time employee has made a significant impact on compliance.

370 Bond Debt Fund

This Fund is used to pay our General Fund obligations. A transfer from the General Fund is made to the Bond Debt Fund to cover this obligation.

470 Capital Construction Fund

This fund was initially set up to track all expenses relating to the construction of the new City Hall. Since the project is complete this fund is no longer needed. We can use it in the future if a construction project is needed.

592 Water & Sewer Fund

Water & Sewer Fund accounts for the City providing water and sewer services to the residents and businesses in the City. Revenue is provided primarily through user fees. The state requires that revenues in this fund must cover any costs for the services.

Revenues were estimated almost to the penny. We collected 99.9% of our total anticipated budget. Revenues from water and sewer sales were recorded at 5% above our anticipated level and interest earned exceeded anticipated revenue.

Expenditures were allocated as follows:

Operations	\$325,566
Repairs & maintenance	54,315
Depreciation	150,544

We increased our net assets in the amount of \$407,461. The Stormwater project added \$70,536 to construction in progress totaling \$147,069. Maple Street construction in progress is \$4,926. The Derwich project added \$258,155 and the Young Street Extension added \$101,450, both of which are complete. The Southside/Lawndale & Fulton Project added \$260,864 and is slated to be completed in the 05-06 fiscal year. It was a very productive year for the enterprise fund.

We are confident that continued diligence and annual rate increases will improve this financial situation.

661 Internal Service Fund

Think of the Internal Service Fund as the City's motor pool. It accounts for the cost of acquiring, maintaining, and providing vehicles and equipment for various City departments. This includes the cost of buildings to house that equipment. Each department pays a rental charge to the fund for their use of its equipment. This allows the Internal Service Fund to replace City equipment when necessary.

Its initial balance was a transfer from the General Fund. The revenue from equipment rental does not cover the cost of purchasing equipment or depreciation. Over the years, the General Fund has transferred money to the Internal Service Fund on a regular basis. This money has been used for the purchase of the equipment. The rental revenue covers the cost of maintaining, repairing and fueling the equipment. Since 1997 the Internal Service Fund has paid the cost of these purchases.

In an effort to maintain efficiency we have replaced our Vactor Truck at a cost of \$116,184. This price is net of the trade-in value of our old Vactor.

CONDENSED FINANCIAL STATEMENT INFORMATION:

City of Grayling
Changes in Net Assets
June 30, 2005 and 2004

	Governmental Activities		Business-type Activities		Total	
	2005	2004	2005	2004	2005	2004
Revenue						
Program revenues:						
Charges for services	\$ 223,750	\$ 225,300	\$ 611,539	\$ 523,386	\$ 835,289	\$ 748,686
Operating grants and contributions	159,842	193,171	31,591	13,130	191,433	206,301
Capital grants and contributions	932,494	21,956	-	76,532	932,494	98,488
General revenues:						
Property taxes	780,687	725,541	-	-	780,687	725,541
Income taxes	432,194	335,624	-	-	432,194	335,624
Sales taxes	231,735	240,852	-	-	231,735	240,852
Alcohol beverage taxes	5,567	4,965	-	-	5,567	4,965
Unrestricted investment earnings	221,574	170,989	16,451	6,784	238,025	177,773
Sale of property	59,085	31,729	-	-	59,085	31,729
Other	21,215	13,375	-	-	21,215	13,375
Transfers	(359,605)	(43,252)	359,605	43,252	-	-
Total revenues	2,708,538	1,920,250	1,019,186	663,084	3,727,724	2,583,334
Function/Program Expenses						
Legislative	20,483	18,469	-	-	20,483	18,469
General government	910,151	1,056,683	-	-	910,151	1,056,683
Public safety	699,807	330,826	-	-	699,807	330,826
Public works	152,500	127,589	-	-	152,500	127,589
Highways and streets	533,844	495,260	-	-	533,844	495,260
Culture and recreation	22,257	30,594	-	-	22,257	30,594
Debt service	43,442	41,638	-	-	43,442	41,638
Water and sewer	-	-	611,725	630,484	611,725	630,484
Total expenses	2,382,484	2,101,059	611,725	630,484	2,994,209	2,731,543
Change in net assets	326,054	(180,809)	407,461	32,600	733,515	(148,209)
Net assets - beginning of year	7,619,307	7,800,116	4,592,221	4,559,621	12,211,528	12,359,737
Net assets - end of year	\$ 7,945,361	\$ 7,619,307	\$ 4,999,682	\$ 4,592,221	\$ 12,945,043	\$ 12,211,528

City of Grayling
Statement of Net Assets
June 30, 2005 and 2004

	Governmental Activities		Business-type Activities		Total	
	2005	2004	2005	2004	2005	2004
Assets						
Current and other assets	\$ 3,693,208	\$ 3,893,692	\$ 1,365,781	\$ 1,278,667	\$ 5,058,989	\$ 5,172,359
Capital assets - net of accum. dep.	5,855,346	5,207,043	5,599,330	5,053,941	11,454,676	10,260,984
Total assets	\$ 9,548,554	\$ 9,100,735	\$ 6,965,111	\$ 6,332,608	\$ 16,513,665	\$ 15,433,343
Liabilities						
Current liabilities	\$ 732,044	\$ 363,170	\$ 371,429	\$ 114,387	\$ 1,103,473	\$ 477,557
Bonds payable, long-term portion	871,149	1,118,258	1,594,000	1,626,000	2,465,149	2,744,258
Total liabilities	1,603,193	1,481,428	1,965,429	1,740,387	3,568,622	3,221,815
Net Assets						
Investment in capital assets						
net of related debt	4,777,823	4,090,556	3,973,330	3,397,941	8,751,153	7,488,497
Restricted	-	-	90,004	130,123	90,004	130,123
Unrestricted	3,167,538	3,528,751	936,348	1,064,157	4,103,886	4,592,908
Total net assets	7,945,361	7,619,307	4,999,682	4,592,221	12,945,043	12,211,528
Total liabilities and net assets	\$ 9,548,554	\$ 9,100,735	\$ 6,965,111	\$ 6,332,608	\$ 16,513,665	\$ 15,433,343

Long-term Debt

Governmental Activities: \$ 1,077,523
Business-type Activities: 1,626,000

Analysis of Original budget to Actual and Amended

General Fund revenues actual year-to-date exceeded the original adopted budget due to grant money received for the Fire Dept. FEMA Grant in the amount of \$484,492. Crawford County contributed \$37,640 for purchase of an air compressor, and the Rotary Club of Grayling donated \$3,180 for the purchase of a rescue sled. Weyerhaeuser donated \$1,000 for the Ice Rink.

General Fund expenditures actual year-to-date exceeded the original adopted budget because we bought a new fire truck and equipment with the FEMA Grant received. We also added a part-time zoning administrator and underestimated audit fees for first year of GASB 34 implementation.

Variations in Major Street revenues and expenditures were due to a crack sealing project added mid-year.

Variations in Local Street revenues and expenditures were due to the added Southside project (\$158,025), the crack sealing project (\$9,952), the Derwich Grant (\$26,753), and Young Street Grant (\$88,283).

Income Tax Fund budget vs. actual variations reflect amendments made during the fiscal year to cover capital projects and a local match for grants received. Significant changes were due to Southside project, Derwich and Young Street Grant, and the City portion of the Streetscape MDOT project.

Water and Sewer Fund variations were due to the added Southside project, Derwich and Young Street, and Stormwater project.

KNOWN FACTORS AFFECTING FUTURE OPERATIONS:

We have several projects that will be completed in the next fiscal year. Unfortunately we do not have final completion numbers on every project. However, we believe we have provided the most accurate numbers possible. Last fiscal year our financial deficits were largely due to projects added that were not included in the original budget. Caution should be exercised for any future commitments until a budget analysis can be completed and the net effect can be determined.

CONTACTING ENTITY MANAGEMENT:

This financial report is designed to provide our taxpayers, creditors, investors and interested parties with a general overview of the entity's finances and to demonstrate the entity's accountability for the revenues it receives. If you have questions concerning this report, please contact City Of Grayling, P.O. Box 549, Grayling, MI 49738 or call (989) 348-2131.

Allen Lowe, Manager

Terry McGregor, Treasurer

CITY OF GRAYLING
Statement of Net Assets
June 30, 2005

<u>Assets</u>	<u>Governmental Activities</u>	<u>Business-type Activities</u>	<u>Total</u>
Current Assets			
Cash	\$ 2,859,070	\$ 820,175	\$ 3,679,245
Investments	477,000	245,000	722,000
Accounts receivable	-	186,840	186,840
Taxes receivable	9,773	-	9,773
Due from fiduciary fund	3	-	3
Due from other governmental units	325,100	-	325,100
Internal balances	(3,750)	3,750	-
Inventory	-	18,900	18,900
Prepaid expenses	26,012	1,112	27,124
	<u>3,693,208</u>	<u>1,275,777</u>	<u>4,968,985</u>
Total current assets			
Noncurrent Assets			
Restricted cash	-	90,004	90,004
Land	148,421	-	148,421
Buildings	2,104,939	-	2,104,939
Machinery and equipment	2,740,840	8,054,575	10,795,415
Infrastructure	7,812,574	-	7,812,574
Construction in progress	205,381	412,859	618,240
Less: accumulated depreciation	(7,156,809)	(2,868,104)	(10,024,913)
	<u>5,855,346</u>	<u>5,689,334</u>	<u>11,544,680</u>
Total noncurrent assets			
Total assets	<u>\$ 9,548,554</u>	<u>\$ 6,965,111</u>	<u>\$ 16,513,665</u>

CITY OF GRAYLING
Statement of Net Assets
(Continued)
June 30, 2005

	Governmental Activities	Business-type Activities	Total
<u>Liabilities and Net Assets</u>			
Current Liabilities			
Accrued expenses	\$ 37,573	\$ 6,025	\$ 43,598
Accounts payable	247,621	292,754	540,375
Accrued interest payable	15,605	40,650	56,255
Due to other governmental units	10,063	-	10,063
Deferred revenue	163,659	-	163,659
Notes payable, due within one year	227,523	-	227,523
Bonds payable, due within one year	30,000	32,000	62,000
	<u>732,044</u>	<u>371,429</u>	<u>1,103,473</u>
Total current liabilities			
Noncurrent Liabilities			
Compensated absences payable	51,149	-	51,149
Bonds payable	820,000	1,594,000	2,414,000
	<u>871,149</u>	<u>1,594,000</u>	<u>2,465,149</u>
Total noncurrent liabilities			
	<u>1,603,193</u>	<u>1,965,429</u>	<u>3,568,622</u>
Total liabilities			
Net Assets			
Invested in capital assets, net of related debt	4,777,823	3,973,330	8,751,153
Restricted	-	90,004	90,004
Unrestricted	3,167,538	936,348	4,103,886
	<u>7,945,361</u>	<u>4,999,682</u>	<u>12,945,043</u>
Total net assets			
	<u>\$ 9,548,554</u>	<u>\$ 6,965,111</u>	<u>\$ 16,513,665</u>
Total liabilities and net assets			

CITY OF GRAYLING
Statement of Activities
For the Year Ended June 30, 2005

Functions/Programs	Program Revenues				Net (Expense) Revenue and Changes in Net Assets		
	Expenses	Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Governmental Activities	Business-type Activities	Total
Primary Government							
Governmental activities:							
Legislative	\$ 20,483	\$ -	\$ -	\$ -	\$ (20,483)	\$ -	\$ (20,483)
General government	910,151	223,750	-	396,291	(290,110)	-	(290,110)
Public safety	699,807	-	1,219	536,203	(162,385)	-	(162,385)
Public works	152,500	-	-	-	(152,500)	-	(152,500)
Highways and streets	533,844	-	158,623	-	(375,221)	-	(375,221)
Culture and recreation	22,257	-	-	-	(22,257)	-	(22,257)
Debt service	43,442	-	-	-	(43,442)	-	(43,442)
Total governmental activities	2,382,484	223,750	159,842	932,494	(1,066,398)	-	(1,066,398)
Business-type activities:							
Water and Sewer	611,725	611,539	31,591	-	-	31,405	31,405
Total primary government	\$ 2,994,209	\$ 835,289	\$ 191,433	\$ 932,494	(1,066,398)	31,405	(1,034,993)
General revenues:							
Property taxes					780,687	-	780,687
Income taxes					432,194	-	432,194
Sales taxes					231,735	-	231,735
Alcoholic beverage taxes					5,567	-	5,567
Unrestricted investment earnings					221,574	16,451	238,025
Sale of property					59,085	-	59,085
Other					21,215	-	21,215
Transfers					(359,605)	359,605	-
Total general revenues and transfers					1,392,452	376,056	1,768,508
Change in net assets					326,054	407,461	733,515
Net assets - beginning of year					7,619,307	4,592,221	12,211,528
Net assets - end of year					\$ 7,945,361	\$ 4,999,682	\$ 12,945,043

See accompanying notes to the basic financial statements.

CITY OF GRAYLING
Balance Sheet
Governmental Funds
June 30, 2005

<u>Assets</u>	<u>General</u>	<u>Major Street</u>	<u>Local Street</u>
Cash	\$ 1,459,685	\$ 168,629	\$ 90,680
Investments	477,000	-	-
Taxes receivable	9,773	-	-
Due from other funds	11,098	-	119,758
Due from other governmental units	78,337	16,036	14,436
Prepaid expenditures	23,106	1,256	565
	<hr/>	<hr/>	<hr/>
Total assets	<u>\$ 2,058,999</u>	<u>\$ 185,921</u>	<u>\$ 225,439</u>
 <u>Liabilities and Fund Balances</u>			
Liabilities			
Accrued expenditures	\$ 27,639	\$ 3,416	\$ 2,505
Accounts payable	32,889	6,330	203,922
Due to other funds	-	-	-
Due to other governmental units	10,063	-	-
Deferred revenue	-	-	-
	<hr/>	<hr/>	<hr/>
Total liabilities	<u>70,591</u>	<u>9,746</u>	<u>206,427</u>
 Fund balances			
Unreserved, designated for:			
Cemetery expenditures	520,808	-	-
Fire protection expenditures	58,948	-	-
Unfunded pension	393,322	-	-
Streetscape grant	-	-	-
Recreation	-	-	-
Southside	-	-	-
Storm water	-	-	-
Unreserved, undesignated:			
General fund	1,015,330	-	-
Special revenue funds	-	176,175	19,012
	<hr/>	<hr/>	<hr/>
Total fund balances	<u>1,988,408</u>	<u>176,175</u>	<u>19,012</u>
	<hr/>	<hr/>	<hr/>
Total liabilities and fund balances	<u>\$ 2,058,999</u>	<u>\$ 185,921</u>	<u>\$ 225,439</u>

See accompanying notes to the basic financial statements.

Income Tax	Other Nonmajor Governmental Funds	Total Governmental Funds
\$ 935,926	\$ -	\$ 2,654,920
-	-	477,000
-	-	9,773
-	-	130,856
216,291	-	325,100
-	-	24,927
<u>\$ 1,152,217</u>	<u>\$ -</u>	<u>\$ 3,622,576</u>
\$ 1,739	\$ -	\$ 35,299
-	-	243,141
134,603	-	134,603
-	-	10,063
163,659	-	163,659
<u>300,001</u>	<u>-</u>	<u>586,765</u>
-	-	520,808
-	-	58,948
-	-	393,322
152,398	-	152,398
76,195	-	76,195
138,014	-	138,014
42,000	-	42,000
-	-	1,015,330
443,609	-	638,796
<u>852,216</u>	<u>-</u>	<u>3,035,811</u>
<u>\$ 1,152,217</u>	<u>\$ -</u>	<u>\$ 3,622,576</u>

CITY OF GRAYLING
Reconciliation of Governmental Funds Balance Sheet to the
Statement of Net Assets
June 30, 2005

Total Fund Balance - Governmental Funds

\$ 3,035,811

Amounts reported for governmental activities in the statement of net assets
are different because:

Governmental funds report capital outlays as expenditures. However,
in the statement of net assets, these assets are capitalized and depreciated
over their estimated useful lives.

Governmental capital assets	12,023,018
Accumulated depreciation	(6,760,321)

Governmental funds report interest when due, whereas in the statement of net assets, interest is accrued on outstanding bonds.	(15,605)
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Long-term liabilities, including bonds payable, are not due and payable
in the current period and therefore are not reported in the governmental
funds.

Governmental bonds payable	(850,000)
Governmental notes payable	(227,523)
Compensated absences	(51,149)

The Internal Service Fund is used to charge motor vehicle usage costs
to various departments within the City. The assets and liabilities
of the Internal Service Fund are included in governmental activities
in the statement of net assets.

791,130

Net Assets of Governmental Activities

\$ 7,945,361

CITY OF GRAYLING
Statement of Revenues, Expenditures, and Changes in Fund Balances
Governmental Funds
For the Year Ended June 30, 2005

	General	Major Street	Local Street
Revenues			
Taxes	\$ 780,687	\$ -	\$ -
Federal revenue	484,492	-	-
State revenue	252,592	102,428	56,195
Charges for services	223,750	-	-
Interest and rentals	195,521	2,910	214
Other	58,855	-	-
Intergovernmental revenues	54,884	-	-
	<hr/>	<hr/>	<hr/>
Total revenues	2,050,781	105,338	56,409
	<hr/>	<hr/>	<hr/>
Expenditures			
Current:			
Culture and recreation	84,197	-	-
General government	548,697	-	-
Highways and streets	-	155,523	381,264
Legislative	20,483	-	-
Public safety	608,543	-	-
Public works	138,586	-	-
Debt service:			
Interest	-	-	-
Principal retirement	-	-	-
Capital outlay:			
Public safety	610,927	-	-
	<hr/>	<hr/>	<hr/>
Total expenditures	2,011,433	155,523	381,264
	<hr/>	<hr/>	<hr/>
Excess (deficiency) of revenues over expenditures	39,348	(50,185)	(324,855)
	<hr/>	<hr/>	<hr/>
Other financing sources (uses)			
Transfers in	66,610	9,952	309,094
Transfers out	(122,652)	-	-
Sale of property	59,085	-	-
	<hr/>	<hr/>	<hr/>
Total other financing sources (uses)	3,043	9,952	309,094
	<hr/>	<hr/>	<hr/>
Net change in fund balances	42,391	(40,233)	(15,761)
	<hr/>	<hr/>	<hr/>
Fund balances - beginning of year	1,946,017	216,408	34,773
	<hr/>	<hr/>	<hr/>
Fund balances - end of year	\$ 1,988,408	\$ 176,175	\$ 19,012
	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>

See accompanying notes to the basic financial statements.

Income Tax	Other Nonmajor Governmental Funds	Total Governmental Funds
\$ 432,194	\$ -	\$ 1,212,881
396,291	-	880,783
-	-	411,215
-	-	223,750
19,042	-	217,687
-	-	58,855
-	-	54,884
<u>847,527</u>	<u>-</u>	<u>3,060,055</u>
-	-	84,197
361,815	-	910,512
-	-	536,787
-	-	20,483
-	-	608,543
-	-	138,586
-	43,688	43,688
-	38,964	38,964
-	-	610,927
<u>361,815</u>	<u>82,652</u>	<u>2,992,687</u>
<u>485,712</u>	<u>(82,652)</u>	<u>67,368</u>
-	82,652	468,308
(821,445)	-	(944,097)
-	-	59,085
<u>(821,445)</u>	<u>82,652</u>	<u>(416,704)</u>
(335,733)	-	(349,336)
<u>1,187,949</u>	<u>-</u>	<u>3,385,147</u>
<u>\$ 852,216</u>	<u>\$ -</u>	<u>\$ 3,035,811</u>

CITY OF GRAYLING
Reconciliation of the Statement of Revenues, Expenditures, and
Changes in Fund Balances of Governmental Funds to the
Statement of Activities
For the Year Ended June 30, 2005

Net Change in Fund Balances - Total Governmental Funds	\$ (349,336)
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Amounts reported for governmental activities in the statement of activities are different because:

Governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of these assets is allocated over their estimated useful lives as depreciation.

Expenditures for capital assets	953,092
Current year depreciation	(436,056)

Repayment of bond and note principal is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the statement of net assets. This is the amount of principal paid on long-term debt.	38,964
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Interest on long-term debt is recognized as an expenditure when it is due in the governmental funds. However, in the statement of activities, interest expense is recognized as the interest accrues, regardless of when it is due.	246
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Compensated absences are recognized as an expenditure when it is paid in the governmental funds. In the statement of activities, however, compensated absences are recognized as an expense when earned.	(10,413)
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The Internal Service Fund is used to charge motor vehicle usage costs to various departments within the city. The net revenue (expense) of the Internal Service Fund is included in governmental activities in the statement of activities. Depreciation is excluded from this adjustment due to inclusion above.	<div style="border-top: 1px solid black; border-bottom: 3px double black;">129,557</div>
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Change in Net Assets of Governmental Activities	<div style="border-top: 1px solid black; border-bottom: 3px double black;">\$ 326,054</div>
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CITY OF GRAYLING
Statement of Revenues, Expenditures, and Changes in Fund Balance - Budget and Actual
General Fund
For the Year Ended June 30, 2005

	Budgeted Amounts		Actual Amounts	Variance with Final Budget Over/(Under)
	Original	Final		
Revenues				
Taxes	\$ 774,440	\$ 774,440	\$ 780,687	\$ 6,247
Federal revenue	-	525,312	484,492	(40,820)
State revenue	243,000	243,000	252,592	9,592
Charges for services	237,664	240,464	223,750	(16,714)
Interest and rentals	172,789	172,789	195,521	22,732
Other	5,000	5,000	58,855	53,855
Intergovernmental revenues	54,884	54,884	54,884	-
Total revenues	<u>1,487,777</u>	<u>2,015,889</u>	<u>2,050,781</u>	<u>34,892</u>
Expenditures				
Current:				
Culture and recreation	135,925	136,325	84,197	(52,128)
General government	639,070	669,058	548,697	(120,361)
Legislative	22,900	22,900	20,483	(2,417)
Public safety	601,522	608,597	608,543	(54)
Public works	134,200	134,200	138,586	4,386
Capital outlay:				
Public safety	44,900	610,745	610,927	182
Total expenditures	<u>1,578,517</u>	<u>2,181,825</u>	<u>2,011,433</u>	<u>(170,392)</u>
Excess (deficiency) of revenues over expenditures	<u>(90,740)</u>	<u>(165,936)</u>	<u>39,348</u>	<u>205,284</u>
Other financing sources (uses)				
Sale of property	42,200	42,200	59,085	16,885
Transfers in	116,325	116,725	66,610	(50,115)
Transfers out	(160,299)	(164,364)	(122,652)	41,712
Total other financing sources (uses)	<u>(1,774)</u>	<u>(5,439)</u>	<u>3,043</u>	<u>8,482</u>
Net change in fund balance	<u>(92,514)</u>	<u>(171,375)</u>	<u>42,391</u>	<u>213,766</u>
Fund balance - beginning of year	<u>1,946,017</u>	<u>1,946,017</u>	<u>1,946,017</u>	<u>-</u>
Fund balance - end of year	<u>\$ 1,853,503</u>	<u>\$ 1,774,642</u>	<u>\$ 1,988,408</u>	<u>\$ 213,766</u>

CITY OF GRAYLING
Statement of Revenues, Expenditures, and Changes in Fund Balance - Budget and Actual
Major Street Fund
For the Year Ended June 30, 2005

	Budgeted Amounts		Actual Amounts	Variance with Final Budget Over/(Under)
	Original	Final		
Revenues				
State revenue	\$ 108,720	\$ 108,720	\$ 102,428	\$ (6,292)
Interest and rentals	1,000	1,000	2,910	1,910
Total revenues	109,720	109,720	105,338	(4,382)
Expenditures				
Current:				
Highways and streets	146,902	164,654	155,523	(9,131)
Excess (deficiency) of revenues over expenditures	37,182	54,934	50,185	4,749
Other financing sources (uses)				
Transfers in	-	9,952	9,952	-
Net change in fund balance	(37,182)	(44,982)	(40,233)	4,749
Fund balance - beginning of year	216,408	216,408	216,408	-
Fund balance - end of year	\$ 179,226	\$ 171,426	\$ 176,175	\$ 4,749

CITY OF GRAYLING
Statement of Revenues, Expenditures, and Changes in Fund Balance - Budget and Actual
Local Street Fund
For the Year Ended June 30, 2005

	<u>Budgeted Amounts</u>		<u>Actual</u>	<u>Variance with</u>
	<u>Original</u>	<u>Final</u>	<u>Amounts</u>	<u>Final Budget</u>
				<u>Over/(Under)</u>
Revenues				
State revenue	\$ 49,267	\$ 49,267	\$ 56,195	\$ 6,928
Interest and rentals	500	500	214	(286)
Total revenues	<u>49,767</u>	<u>49,767</u>	<u>56,409</u>	<u>6,642</u>
Expenditures				
Current:				
Highways and streets	<u>131,478</u>	<u>670,944</u>	<u>381,264</u>	<u>(289,680)</u>
Excess (deficiency) of revenues over expenditures	<u>81,711</u>	<u>(621,177)</u>	<u>324,855</u>	<u>296,322</u>
Other financing sources (uses)				
Transfers in	<u>81,711</u>	<u>628,977</u>	<u>309,094</u>	<u>(319,883)</u>
Net change in fund balance	-	7,800	(15,761)	(23,561)
Fund balance - beginning of year	<u>34,773</u>	<u>34,773</u>	<u>34,773</u>	<u>-</u>
Fund balance - end of year	<u>\$ 34,773</u>	<u>\$ 42,573</u>	<u>\$ 19,012</u>	<u>\$ (23,561)</u>

CITY OF GRAYLING
Statement of Revenues, Expenditures, and Changes in Fund Balance - Budget and Actual
Income Tax Fund
For the Year Ended June 30, 2005

	<u>Budgeted Amounts</u>		<u>Actual</u>	<u>Variance with</u>
	<u>Original</u>	<u>Final</u>	<u>Amounts</u>	<u>Final Budget</u>
				<u>Over/(Under)</u>
Revenues				
Taxes	\$ 400,000	\$ 400,000	\$ 432,194	\$ 32,194
Federal revenue	-	480,000	396,291	(83,709)
Interest and rentals	8,000	8,000	19,042	11,042
	<u>408,000</u>	<u>888,000</u>	<u>847,527</u>	<u>(40,473)</u>
Total revenues				
Expenditures				
Current:				
General government	827,975	546,975	361,815	(185,160)
	<u>827,975</u>	<u>546,975</u>	<u>361,815</u>	<u>(185,160)</u>
Excess (deficiency) of revenues over expenditures	(419,975)	341,025	485,712	144,687
	<u>(419,975)</u>	<u>341,025</u>	<u>485,712</u>	<u>144,687</u>
Other financing sources (uses)				
Transfers out	(120,000)	(1,226,440)	(821,445)	404,995
	<u>(120,000)</u>	<u>(1,226,440)</u>	<u>(821,445)</u>	<u>404,995</u>
Net change in fund balance	(539,975)	(885,415)	(335,733)	549,682
Fund balance - beginning of year	1,187,949	1,187,949	1,187,949	-
	<u>1,187,949</u>	<u>1,187,949</u>	<u>1,187,949</u>	<u>-</u>
Fund balance - end of year	\$ 647,974	\$ 302,534	\$ 852,216	\$ 549,682
	<u>\$ 647,974</u>	<u>\$ 302,534</u>	<u>\$ 852,216</u>	<u>\$ 549,682</u>

CITY OF GRAYLING
Statement of Net Assets
Proprietary Funds
June 30, 2005

	Business-type Activities - Enterprise Fund Water and Sewer	Governmental Activities - Internal Service Fund
<u>Assets</u>		
Current Assets		
Cash	\$ 820,175	\$ 204,150
Investments	245,000	-
Accounts receivable	186,840	-
Due from other funds	3,750	-
Due from other governmental units	-	-
Inventory	18,900	-
Prepaid expenses	1,112	1,085
Total current assets	<u>1,275,777</u>	<u>205,235</u>
Noncurrent Assets		
Restricted cash	90,004	-
Construction in progress	412,859	-
Machinery and equipment	8,054,575	989,137
Less: accumulated depreciation	<u>(2,868,104)</u>	<u>(396,488)</u>
Total noncurrent assets	<u>5,689,334</u>	<u>592,649</u>
Total assets	<u><u>\$ 6,965,111</u></u>	<u><u>\$ 797,884</u></u>
<u>Liabilities and Net Assets</u>		
Current Liabilities		
Accrued expenses	\$ 6,025	\$ 2,274
Accounts payable	292,754	4,480
Accrued interest	40,650	-
Bonds payable - current	<u>32,000</u>	<u>-</u>
Total current liabilities	371,429	6,754
Noncurrent Liabilities		
Bonds payable	<u>1,594,000</u>	<u>-</u>
Total liabilities	<u>1,965,429</u>	<u>6,754</u>
Net Assets		
Invested in capital assets, net of related debt	3,973,330	592,649
Restricted for stormwater project	557	-
Restricted for bond covenants	89,447	-
Unrestricted	<u>936,348</u>	<u>198,481</u>
Total net assets	<u>4,999,682</u>	<u>791,130</u>
Total liabilities and net assets	<u><u>\$ 6,965,111</u></u>	<u><u>\$ 797,884</u></u>

CITY OF GRAYLING
Statement of Revenues, Expenses, and Changes in Fund Net Assets
Proprietary Funds
For the Year Ended June 30, 2005

	Business-type Activities - Enterprise Fund Water and Sewer	Governmental Activities - Internal Service Fund
Operating revenues		
Charges for services	\$ 611,539	\$ 149,000
Operating expenses		
Personnel	163,987	62,663
Contractual	100,475	17,798
Supplies	9,728	27,801
Utilities	51,376	9,691
Repair & maintenance	54,315	21,561
Depreciation	150,544	50,636
Total operating expenses	530,425	190,150
Operating income (loss)	81,114	(41,150)
Nonoperating revenues		
Interest and rentals	16,451	3,887
Federal revenues	3,125	-
State revenues	28,466	-
Total nonoperating revenues	48,042	3,887
Nonoperating expenses		
Interest	(81,300)	-
Total nonoperating revenues (expenses)	(33,258)	3,887
Income (loss) before operating transfers and capital contributions	47,856	(37,263)
Operating transfers in	359,605	116,184
Change in net assets	407,461	78,921
Total net assets - beginning	4,592,221	712,209
Total net assets - ending	\$ 4,999,682	\$ 791,130

CITY OF GRAYLING
Statement of Cash Flows
Proprietary Funds
For the Year Ended June 30, 2005

	Business-type Activities - Enterprise Fund Water and Sewer	Governmental Activities - Internal Service Fund
Cash flows from operating activities		
Cash received from customers	\$ 591,906	\$ -
Receipts from interfund services provided	-	149,000
Payments to employees	(165,903)	(62,073)
Payments to suppliers	(164,377)	(64,217)
Payments for interfund services used	(81,279)	(9,548)
	<u>180,347</u>	<u>13,162</u>
Net cash provided (used) by operating activities		
Cash flows from non-capital financing activities		
Subsidy from federal/state grant	<u>31,591</u>	<u>-</u>
Cash flows from capital and related financing activities		
Transfer from other funds	355,855	116,184
Capital contributions	23,163	-
Acquisition and construction of capital assets	(409,575)	(131,267)
Interest paid on revenue bonds	(82,050)	-
Principal paid on revenue bonds	(30,000)	-
	<u>(142,607)</u>	<u>(15,083)</u>
Net cash provided (used) for capital investing activities		
Cash flows from investing activities		
Interest received	16,451	3,887
Purchase of investments	(245,000)	-
Net cash provided (used) by investing activities	<u>(228,549)</u>	<u>3,887</u>
Net increase (decrease) in cash	(159,218)	1,966
Cash, beginning	<u>1,069,397</u>	<u>202,184</u>
Cash, ending	<u><u>\$ 910,179</u></u>	<u><u>\$ 204,150</u></u>
Reconciliation of operating income to net cash provided (used) by operating activities		
Operating income (loss)	<u>\$ 81,114</u>	<u>\$ (41,150)</u>
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	150,544	50,636
(Increase) decrease in customer receivables	(19,633)	-
(Increase) decrease in prepaid expenses	(1,112)	(1,085)
Increase (decrease) in accounts payable	(29,762)	3,086
Increase (decrease) in accrued expenses	(804)	1,675
	<u>99,233</u>	<u>54,312</u>
Total adjustments		
Net cash provided (used) by operating activities	<u><u>\$ 180,347</u></u>	<u><u>\$ 13,162</u></u>

CITY OF GRAYLING
Statement of Fiduciary Net Assets
Fiduciary Funds
June 30, 2005

	<u>Agency Fund</u>
<u>Assets</u>	
Cash	\$ 3
	<u> </u>
<u>Liabilities</u>	
Due to other funds	\$ 3
	<u> </u>

CITY OF GRAYLING
NOTES TO FINANCIAL STATEMENTS
June 30, 2005

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The City of Grayling ("the City") was incorporated in May 1935 under the provisions of Act 279, P.A. 1909, as amended (Home Rule City Act). The City operates under a Council-Manager form of government and provides the following services as authorized by its charter: public safety (police and fire), highways and streets, cemetery, sanitation, health and social services, culture and recreation, public improvements, planning and zoning, and general administrative services.

The City's financial statements are prepared in accordance with generally accepted accounting principles (GAAP). The Governmental Accounting Standards Board (GASB) is the standard-setting body for governmental accounting and financial reporting. The City's reporting entity applies all relevant Governmental Accounting Standards Board (GASB) pronouncements. Proprietary funds and similar component units apply Financial Accounting Standards Board (FASB) pronouncements and Accounting Principles Board (APB) opinions issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements, in which case, GASB prevails. Pronouncements of the FASB issued after November 30, 1989 are not applied in the preparation of the financial statements of the proprietary funds in accordance with GASB Statement No. 20. The following is a summary of the significant policies used by the City of Grayling:

REPORTING ENTITY

The accompanying financial statements have been prepared in accordance with criteria established by GASB No. 14, and amended by GASBS No. 39. GASBS 14 states that the primary basis for determining whether outside agencies and organizations should be considered component units of the City and included in the City's financial statements is financial accountability. Financial accountability has been defined as follows: A primary government has substantive authority to appoint a voting majority of the component unit's board; the primary government is either able to impose its will on a component unit or there is a potential for the component unit to provide specific financial burdens on the primary government; and the component unit is fiscally dependent on the primary government. The City has no component units.

RELATED ORGANIZATION

The Grayling Housing Commission ("the Commission") is governed by a five-member board appointed by the Grayling City Council. The Commission is legally separate and not financially accountable to the City of Grayling, thus it is not shown as part of the City's financial statements. Complete financial statements for the Commission can be obtained from its administrative office.

BASIC FINANCIAL STATEMENTS – OVERVIEW

The City of Grayling's basic financial statements include both government-wide (reporting the City as a whole) and fund financial statements (reporting the City's major funds). Both the government-wide and the fund financial statements categorize primary government activities as either governmental or business-type. Governmental activities, which normally are supported by taxes and intergovernmental revenues, are reported separately from business-type activities, which rely to a significant extent on fees and charges for support. The primary government is reported separately from legally separate component units for which the primary government is financially accountable. The City has no component units.

NOTES TO FINANCIAL STATEMENTS – CONTINUED

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – CONTINUED

BASIC FINANCIAL STATEMENTS – GOVERNMENT-WIDE STATEMENTS

The government-wide financial statements report information on all of the non-fiduciary activities of the primary government and its component units. As a general rule the effect of interfund activity, such as overhead costs, has been eliminated from these statements. The government-wide focus is more on operational efficiency, the sustainability of the City as an entity and the change in the City's net assets resulting from the current year's activities.

The Internal Service fund is consolidated into the governmental column when presented at the government-wide level. This is because the principal users of the internal service are the City's governmental activities. The net profit/loss in the internal service fund is allocated to the functional activity (public safety, public works, etc.) based upon usage.

In the government-wide Statement of Net Assets, both the governmental and business-type activities are presented on a consolidated basis. Due to the full accrual, economic resource basis, all long-term assets and receivables, as well as long-term debt and obligations are recognized. The City's net assets are reported in three parts – invested in capital assets, net of related debt; restricted net assets; and unrestricted net assets. The City first utilizes restricted resources to finance qualifying activities.

The government-wide Statement of Activities demonstrates the degree to which the direct expenses of a given function are offset by program revenues. This statement reduces gross expenses (including depreciation) by related program revenues, which includes charges for services, operating grants and capital grants.

The program revenues must be directly associated with the function. Program revenues include: (1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function; and (2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not properly included among program revenues are reported as general revenue.

BASIC FINANCIAL STATEMENTS – FUND FINANCIAL STATEMENTS

The financial transactions of the City are reported in individual funds in the fund financial statements. Each fund is accounted for by providing a separate set of self-balancing accounts that comprise its assets, liabilities, fund balances, revenues and expenditures/expenses. The focus of the fund financial statement is upon the determination of financial position and changes in financial position (sources, uses, and balances of financial resources).

Government resources are allocated to and accounted for in individual funds based upon the purposes for which they are to be spent and the means by which spending activities are controlled. The emphasis in the fund financial statements is on the major funds in the governmental or business-type categories. GASBS No. 34 sets forth minimum criteria (percentage of the assets, liabilities, revenues or expenditures/expenses of the governmental and proprietary funds) for the determination of major funds.

Governmental Funds

The following is a description of the major governmental funds of the City:

General Fund – The General Fund is the general operating fund of the City. It is used to account for all financial resources except those required to be accounted for in another fund.

NOTES TO FINANCIAL STATEMENTS – CONTINUED

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – CONTINUED

BASIC FINANCIAL STATEMENTS — FUND FINANCIAL STATEMENTS – CONTINUED

Major and Local Street Funds – The Street Funds account for the operation of the street departments. Primary financing is provided by the City's share of state gasoline taxes. State law requires these gasoline taxes to be used to maintain streets.

Income Tax Fund – The Income Tax Fund accounts for the proceeds from the City income tax collections. These collections are reserved for capital improvements.

In addition, the City reports the following non-major governmental funds:

Debt Service Fund – The Debt Service fund accounts for the payment of interest and principal on long-term obligations.

Proprietary Funds

The focus of the proprietary funds is upon the determination of operating income, changes in fund net assets, financial position, and cash flows, which is similar to for-profit businesses. The following is a description of the major proprietary fund of the City:

Water and Sewer Fund – The Water and Sewer Fund is an Enterprise Fund. The fund is financed and operated in a manner similar to a private enterprise. The intent is that costs (expenses, including depreciation) of providing water and sewer services to the general public are recovered through user charges.

In addition, the City reports the following non-major proprietary funds:

Motor Vehicle and Equipment Fund – The Motor Vehicle and Equipment Fund is an internal service fund. This fund accounts for the cost of acquiring, maintaining and providing vehicle and equipment usage to various City departments.

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operation. The principal operating revenues of the Water and Sewer and the Motor Vehicle and Equipment Funds are charges to customers for sales and services. Operating expenses for these funds include the cost of sales and services, administrative expenses and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

Fiduciary Funds

Fiduciary funds are used to account for assets held by the City in a trustee or agent capacity. Since, by definition, these assets are being held for the benefit of a third party (other local governments, private parties, pension participants, etc.) and cannot be used to address activities or obligations of the government, these funds are not incorporated into the government-wide statements. All trust funds employ the same economic resources measurement focus and accrual basis of accounting, as do proprietary funds. Agency funds use the accrual basis of accounting, however, report only assets and liabilities. The following is a description of the fiduciary fund maintained by the City.

NOTES TO FINANCIAL STATEMENTS – CONTINUED

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – CONTINUED

BASIC FINANCIAL STATEMENTS — FUND FINANCIAL STATEMENTS – CONTINUED

Agency Fund – The Agency Fund accounts for the collection and payments of property tax levies.

BASIS OF ACCOUNTING

Basis of accounting refers to the point at which revenues and expenditures/expenses are recognized in the accounts and reported in the financial statements. Basis of accounting relates to the timing of the measurements made, regardless of the measurement focus applied.

The government-wide statements are reported using the economic resources measurement focus and the full accrual basis of accounting, which incorporates long-term assets and receivables as well as long-term debt and obligations. Revenue is recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenue in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met. Expenditures generally are recorded when a liability is incurred.

All proprietary and agency funds are accounted for using the full accrual basis of accounting. Their revenues are recognized when they are earned and their expenses are recognized when they are incurred. Unbilled water and sewer utility service receivables are recorded at year-end.

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recorded in the accounting period in which they are earned, as long as they are both available and measurable. Revenues are available when received within the current period or within 60 days after year end. Expenditures are recorded in the accounting period in which the liability is incurred, as under full accrual accounting. However, debt service expenditures, expenditures relating to compensated absences, and claims and judgments are recorded only when payment is due.

ASSETS, LIABILITIES, AND NET ASSETS OR EQUITY

Cash and Cash Equivalents

Cash and cash equivalents are considered to be cash on hand and demand deposits.

Inventory

Inventory is valued at cost, which approximates market, using the first-in, first-out method.

Interfund Receivables/Payables

Outstanding balances between funds are reported as "due to/from" other funds on the balance sheet of the fund financial statements and as "internal balances" on the Statement of Net Assets of the government-wide financial statements.

Capital Assets

Capital assets, which include property, buildings, equipment and infrastructure assets (e.g., roads, bridges, sidewalks and similar items) are reported in the applicable governmental or business-type activities column in the government-wide financial statements.

NOTES TO FINANCIAL STATEMENTS – CONTINUED

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – CONTINUED

ASSETS, LIABILITIES, AND NET ASSETS OR EQUITY – CONTINUED

Capital assets are recorded by the City when the initial individual costs are equal to or greater than the following amounts:

<u>Asset Type</u>	<u>Amount</u>
Land	\$ 1
Equipment	1,000
Buildings	1,000
Infrastructure	1,000

Capital assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation.

Property, buildings and equipment are depreciated using the straight-line method over the following useful lives:

Buildings	40 to 60 years
Building Improvements	15 to 30 years
Water and Sewer Lines	50 to 75 years
Streets, Curbs and Gutters	10 to 30 years
Vehicles	3 to 5 years
Office Equipment	5 to 7 years

Long-Term Obligations

In the government-wide financial statements and the proprietary fund financial statements, long-term debt and other long-term obligations are reported as liabilities. Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds.

In the fund financial statements, governmental fund types recognize bond premiums and discounts, as well as bond issuance costs during the current period. The face amount of debt issued is reported as other financing sources. Premiums received on debt issuances are reported as other financing sources while discounts are reported as other financing uses. Issuance costs are reported as debt service expenditures.

Compensated Absences (Vacation and Sick Time)

All vacation, sick pay, and other employee benefit amounts accrue when earned in the government-wide and proprietary fund financial statements. Sick and vacation pay are recognized in the governmental financial statements when a payment is made.

Fund Equity

In the fund financial statements, governmental funds report reserved fund balances for amounts that are not available for appropriation or are legally restricted by outside parties for specific purposes. Designations of fund balance represent tentative management plans that are subject to change.

NOTES TO FINANCIAL STATEMENTS – CONTINUED

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – CONTINUED

COMPARATIVE DATA

Comparative data for the prior year is not included in the City's financial statements.

NOTE 2: STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY

Annual budgets are adopted on a basis consistent with generally accepted accounting principles for all operating funds of the City except for the agency fund. Budgetary control is legally maintained at the fund level.

The City follows these procedures in establishing the budgetary data reflected in the financial statements:

1. Prior to the first Council meeting in May, the City Manager submits to the City Council a proposed operating budget for the fiscal year commencing the following July 1. The operating budget includes proposed expenditures/expenses and the means of financing them.
2. A public hearing is conducted at City Hall to obtain taxpayer comments.
3. Prior to July 1, the fund budgets are legally enacted through passage of resolutions.
4. The City Manager is authorized to transfer budgeted amounts between departments within any fund; however, any revisions that alter the total expenditures/expenses of any fund must be approved by the City Council.
5. Formal budgetary integration is employed as a management control device during the year for the General and Special Revenue Funds.
6. Budgeted amounts are as originally adopted, or as amended by the City Council.
7. Encumbrances, which are commitments related to unperformed contracts for goods or services, lapse at year end and are re-appropriated as part of the subsequent year's budget.

Excess of Expenditures Over Appropriations in Budgeted Funds

The City is required under Public Act 621 to adopt a budget for the General and Special Revenue Funds. The City did not incur an excess of expenditures over appropriations for the General or Special Revenue Funds.

NOTE 3: CASH AND INVESTMENTS

Michigan Compiled Laws, Section 129.91, authorizes the City to make deposits and invest in the accounts of federally insured banks, credit unions, and savings and loan associations which have an office in Michigan. The City is allowed to invest in bonds, securities and other direct obligations of the United States or any agency or instrumentality of the United States; United States government or federal agency obligations; repurchase agreements; bankers' acceptance of United States banks; commercial paper rated within the two highest classifications which mature not more than 270 days after the date of purchase; obligations of the State of Michigan or its political subdivisions which are rated as investment grade; and mutual funds composed of investment vehicles which are legal for direct investment by local units of government in Michigan.

The City's deposits and investment policy are in accordance with statutory authority.

NOTES TO FINANCIAL STATEMENTS – CONTINUED

NOTE 3: CASH AND INVESTMENTS – CONTINUED

Cash Deposits

At June 30, 2005, the carrying amount of the City's deposits, including the fiduciary fund, was \$3,769,252 and the bank balance was \$3,818,604.

Pooling of Cash - The City pools cash to maximize its investment return.

<u>Fund</u>	<u>Pooled Cash</u>
Primary Government	
General	\$ 1,242,964
Major Street	168,629
Local Street	90,679
Water and Sewer Fund	798,446
Internal Service Fund	<u>204,150</u>
Total pooled cash	2,504,868
Cash not held in pooled accounts:	<u>1,264,384</u>
Total Cash	<u><u>\$ 3,769,252</u></u>

Federal Depository Insurance

Of the above balance in cash, \$400,000 was covered by federal depository insurance. In addition, \$1,031,989 is collateralized with securities held by the pledging financial institution's trust department in the City's name. The remaining amount was uninsured and uncollateralized. The City may experience significant fluctuations in deposit balances throughout the year.

Investments

Investments are stated at market value. Investments held at a financial institution can be categorized according to three levels of risk. The three levels of risk are:

- | | |
|------------|--|
| Category 1 | Investments that are insured, registered or held by the entity or by its agent in the City's name. |
| Category 2 | Investments that are uninsured and unregistered held by the counterparty's trust department or agent in the City's name. |
| Category 3 | Uninsured and unregistered investments held by the counterparty, its trust or its agent, but not in the City's name. |

The City also has investments in government agency bonds and negotiable certificates of deposits, with a market value of \$380,000 at June 30, 2005. These investments are classified by risk level as Category 3.

The City has a certificate of deposit with a market value of \$97,000 at June 30, 2005. This investment is classified by risk level as Category 1.

NOTES TO FINANCIAL STATEMENTS – CONTINUED

NOTE 4: PROPERTY TAXES

Property taxes are levied and become a lien on property as of July 1 on the State taxable valuation of property in the City as of the preceding December 31. The City bills and collects its own property taxes and also collects taxes for other governmental units. Collection of other governmental unit's taxes and remittance of them to the units are accounted for in the Agency Fund. Property taxes are recognized as revenue in the year for which they are levied.

The City is permitted by charter to levy taxes, subject to State Headlee and Truth in Taxation provisions, up to \$20 per \$1,000 of taxable valuation for general governmental services and for the payment of principal and interest on general obligation long-term debt. The 2004 State taxable valuation of the City of Grayling totaled \$51,040,068.

The tax rate for the year ended June 30, 2005, was as follows:

<u>Purpose</u>	<u>Rate/Taxable Valuation</u>
General governmental services	14.8000 per \$1,000

NOTE 5: INTERFUND RECEIVABLES AND PAYABLES

The interfund balances within the primary government are as follows:

	<u>Interfund Receivable</u>	<u>Interfund Payable</u>
General Fund	\$ 11,098	\$ -
Local Street Fund	119,758	-
Income Tax Fund	-	134,603
Water and Sewer Fund	3,750	-
Fiduciary Fund	-	3
	<u>\$ 134,606</u>	<u>\$ 134,606</u>

The interfund balances are for interest due on property taxes, construction projects, and for grant money restricted for street use.

NOTE 6: INTERFUND TRANSFERS

Operating transfers within the primary government are as follows:

	<u>Transfer In</u>	<u>Transfer Out</u>
General Fund	\$ 66,610	\$ 122,652
Major Street Fund	9,952	-
Local Street Fund	309,094	-
Income Tax Fund	-	821,445
Water and Sewer Fund	359,605	-
Other Nonmajor Govt. Funds	82,652	-
Internal Service Fund	116,184	-
	<u>\$ 944,097</u>	<u>\$ 944,097</u>

The operating transfers are mainly for street improvements, general city operations, debt service and capital improvements.

NOTES TO FINANCIAL STATEMENTS – CONTINUED

NOTE 7: CAPITAL ASSETS

Capital asset activity of the City's primary government for the current year was as follows:

	Balance July 1, 2004	Additions	Deletions	Balance June 30, 2005
Governmental Activities				
Capital assets not being depreciated:				
Land	\$ 148,421	\$ -	\$ -	\$ 148,421
Construction in progress	-	205,382	-	205,382
Subtotal	148,421	205,382	-	353,803
Capital assets being depreciated:				
Buildings	2,104,939	-	-	2,104,939
Equipment	2,062,547	839,596	161,303	2,740,840
Infrastructure	7,671,033	141,541	-	7,812,574
Subtotal	11,838,519	981,137	161,303	12,658,353
Less accum. depreciation:				
Buildings	420,150	42,564	-	462,714
Equipment	1,065,480	137,138	59,144	1,143,474
Infrastructure	5,294,267	256,354	-	5,550,621
Subtotal	6,779,897	436,056	59,144	7,156,809
Net capital assets being depreciated	5,058,622	545,081	102,159	5,501,544
Governmental activities net capital assets	\$ 5,207,043	\$ 750,463	\$ 102,159	\$ 5,855,347

NOTES TO FINANCIAL STATEMENTS – CONTINUED

NOTE 7: CAPITAL ASSETS – CONTINUED

	Balance July 1, 2004	Additions	Deletions	Balance June 30, 2005
Business-type Activities				
Capital assets not being depreciated:				
Construction in progress	\$ 76,532	\$ 336,327	\$ -	\$ 412,859
Capital assets being depreciated:				
Equipment	7,694,970	359,605	-	8,054,575
Less accum. depreciation:				
Equipment	2,717,561	150,543	-	2,868,104
Net capital assets being depreciated	4,977,409	209,062	-	5,186,471
Governmental activities net capital assets	\$ 5,053,941	\$ 545,389	\$ -	\$ 5,599,330

Depreciation expense was charged to the primary government as follows:

Governmental Activities

General government	\$ 64,739
Public safety	85,195
Public works	13,914
Highways and streets	270,128
Culture and recreation	2,080
Total governmental activities	<u>\$ 436,056</u>

Business-type Activities

Water and sewer	<u>\$ 150,544</u>
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NOTES TO FINANCIAL STATEMENTS – CONTINUED

NOTE 7: CAPITAL ASSETS – CONTINUED

Construction Commitments

The City has active construction projects at year-end. The projects include:

	Project Estimates	Expended to 06/30/05	Committed
Stormwater Project	\$ 1,013,937	\$ 147,068	\$ 462,256
Maple Street	210,483	4,926	17,225
Lawndale/Fulton	583,172	418,900	164,272
River Park Development	465,300	37,515	4,785
Cemetery Expansion	90,000	9,832	5,163
	<u>\$ 2,362,892</u>	<u>\$ 618,241</u>	<u>\$ 653,701</u>

At year-end, significant construction in progress amounts are capitalized.

Proprietary Fund Type Property, Plant and Equipment

Proprietary fund type property, plant and equipment at June 30, 2005 are summarized as follows:

	Enterprise	Internal Service
Construction in progress	\$ 412,859	\$ -
Water and sanitary sewer system	8,054,575	-
Equipment	-	989,137
	<u>8,467,434</u>	<u>989,137</u>
Total	(2,868,104)	(396,488)
Less: accumulated dep.		
	<u>\$ 5,599,330</u>	<u>\$ 592,649</u>
Net		

NOTE 8: DEFERRED COMPENSATION PLAN

The City offers its employees a deferred compensation plan created in accordance with Internal Revenue Code 457. The plan, available to all City employees, permits them to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency.

In complying with the amended Section 457 requirements, these assets are now for the exclusive benefit of participants and not subject to the claims of the City's general creditors. As such, they are no longer included in an agency fund of the City.

NOTE 9: DEFINED CONTRIBUTION PLAN

The City provides pension benefits for employees as designated by City Council through a defined contribution plan. In a defined contribution plan, benefits depend solely on amounts contributed to the plan plus investment earnings. As of July 1, 2004, employees are eligible to participate from the date of employment. The City's contributions for each employee (and interest allocated to each employee's account) are fully vested after four years.

NOTES TO FINANCIAL STATEMENTS – CONTINUED

NOTE 9: DEFINED CONTRIBUTION PLAN - CONTINUED

As established by City Council and governed by Federal regulations, the City made the required 11.00% contribution. The City contributed 12.00% for the City Manager. Contributions for the year totaled \$23,225 for the eight employees that participated in this plan. There are no contribution requirements for employees of the City of Grayling.

NOTE 10: DEFINED BENEFIT PENSION PLAN

Plan Description

The City of Grayling participates in the Michigan Municipal Employees' Retirement System (MERS), an agent multiple-employer defined benefit pension plan that covers all employees of the City of Grayling. MERS was established by the State of Michigan for purposes of providing retirement, survivor and disability benefits on a voluntary basis to the State's local government employees. MERS issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by writing to Municipal Employees Retirement System of Michigan, 447 North Canal, Lansing, Michigan 48917.

Funding Policy

There are no contribution requirements for members of the City of Grayling. The City is required to contribute all amounts necessary to fund the system using the actuarial basis specified by statute. The contribution requirements of plan members and the City are established and may be amended by the MERS board.

Annual Pension Cost

For the year ended June 30, 2005, the City's required and actual contributions were \$73,160. The annual required contribution was determined as part of an actuarial valuation at December 31, 2004. The actuarial assumptions included (a) 8% investment rate of return (net of administrative expenses), (b) projected salary increases of 4.50% per year compounded annually, attributable to inflation, (c) additional projected salary increases of 0.0% to 4.50% per year, based on age, attributable to seniority/merit and, (d) the assumption that benefits will increase 2.5% per year (annually) after retirement, for persons under Benefit E-1 or E-2. The contribution rate for normal cost is determined using an entry age actuarial funding method. MERS uses the level percentage of payroll method to amortize the unfunded liability over a 30 year period on a closed basis.

Three-Year Trend Information for the City of Grayling

<u>Fiscal Year Ending</u>	<u>Annual Pension Cost (APC)</u>	<u>Percentage of APC Contributed</u>	<u>Net Pension Obligation</u>
06-30-03	63,660	100%	-
06-30-04	64,676	100%	-
06-30-05	73,160	100%	-

Additional trend information may be found within the Required Supplemental Information section of the financial statements.

NOTE 11: OTHER POST-EMPLOYMENT BENEFITS

The City provides post-employment benefits of health insurance to eligible employees. For the year ended June 30, 2005, there was one participant. The City's actual expense was \$8,361.

NOTES TO FINANCIAL STATEMENTS – CONTINUED

NOTE 12: LONG-TERM DEBT

The following is a summary of the City's long-term debt transactions for the year ended June 30, 2005:

	Beginning Balance	Additions	Reductions	Ending Balance	Amount Due Within One Year
Governmental Activities					
Bonds and notes payable:					
General obligation debt	\$ 875,000	\$ -	\$ 25,000	\$ 850,000	\$ 30,000
installment notes	241,487	-	13,964	227,523	227,523
Total bonds and notes payable	1,116,487	-	38,964	1,077,523	257,523
Compensated absences	40,737	10,412	-	51,149	-
Total governmental activities long-term liabilities	<u>\$ 1,157,224</u>	<u>\$ 10,412</u>	<u>\$ 38,964</u>	<u>\$ 1,128,672</u>	<u>\$ 257,523</u>
Business-type Activities					
Revenue obligation debt	<u>\$ 1,656,000</u>	<u>\$ -</u>	<u>\$ 30,000</u>	<u>\$ 1,626,000</u>	<u>\$ 32,000</u>

Long-term liabilities payable at June 30, 2005, is composed of the following individual issues:

Bond and Note Obligations (Governmental Activities):

\$900,000, 2003 General Obligation bonds due in annual installments of \$30,000 to \$75,000 through August 1, 2022, interest at 2.00% to 5.00%. \$ 850,000

\$255,000, 2003 Installment Note due in quarterly installments of \$3,546 to \$3,602 through February 27, 2006, with a final payment due on May 27, 2006 of \$216,802, interest at 3.1%. 227,523

Total governmental activities bond and note obligations 1,077,523

Compensated Absences 51,149

Total governmental activities long-term liabilities \$ 1,128,672

NOTES TO FINANCIAL STATEMENTS – CONTINUED

NOTE 12: LONG-TERM DEBT – CONTINUED

Revenue Obligation (Business-type Activities):

\$1,140,000, 1991A Water and Sewer bonds due in annual installments of \$19,000 to \$65,000 through July 1, 2030, interest at 5%.

\$ 967,000

\$777,000, 1991B Water and Sewer bonds due in annual installments of \$13,000 to \$445,000 through July 1, 2030, interest at 5%.

659,000

Total business-type activities long-term liabilities \$ 1,626,000

The annual requirements to amortize all general and revenue obligation bonds and notes outstanding, as of June 30, 2005, are as follows:

Annual Requirements to Amortize Outstanding Bonds June 30, 2005

Year Ending June 30	Governmental Activities		Business-type Activities	
	Principal	Interest	Principal	Interest
2006	\$ 257,523	\$ 42,695	\$ 32,000	\$ 80,500
2007	30,000	35,080	32,000	78,900
2008	30,000	34,360	34,000	77,250
2009	35,000	33,436	37,000	75,475
2010	35,000	32,307	38,000	73,600
2011 - 2015	205,000	139,109	222,000	336,650
2016 - 2020	275,000	86,038	286,000	273,400
2021 - 2025	210,000	16,113	366,000	192,400
2026 - 2030	-	-	470,000	88,500
2031 - 2035	-	-	109,000	2,725
Total	<u>\$ 1,077,523</u>	<u>\$ 419,138</u>	<u>\$ 1,626,000</u>	<u>\$ 1,279,400</u>

NOTE 13: DESIGNATED FUND BALANCES/RESTRICTED NET ASSETS

Major Governmental Funds

The General Fund has \$973,078 designated for the cemetery, fire protection and unfunded pension liabilities.

The Income Tax Fund has \$408,607 designated for future capital improvement projects.

Major Proprietary Funds

The Water and Sewer Fund has \$89,447 of its net assets restricted due to revenue bond indentures. This fund also has \$ 557 of its net assets restricted for the stormwater project.

NOTES TO FINANCIAL STATEMENTS – CONTINUED

NOTE 14: CONTINGENCIES

The General Fund is contingently liable for the Water and Sewer System revenue bonds. The General Fund is obligated only if revenues of the Water and Sewer System Fund would be insufficient to meet its debt service requirements.

NOTE 15: RISK MANAGEMENT

The City is exposed to various risks of loss related to torts, theft of, damage to and destruction of assets; errors and omissions; injuries to employees and natural disasters. The City belongs to the Michigan Municipal League Liability and Property Pool, a public entity risk pool currently operating as a common risk management and insurance program for various municipalities throughout the state. The City pays an annual premium for its general insurance coverage. The pool is self-sustaining through member premiums and reinsures through commercial companies for claims in excess of \$500,000 for each insured event. Although the City could be assessed charges beyond the annual premium, the likelihood of receiving such an assessment is minimal. Settled claims have not exceeded coverage in any of the past three years.

NOTE 16: COMMITMENTS

The City has a contract with the Michigan Department of Transportation for improvements along the I-75 corridor. Approximately \$55,000 remains on this commitment at year-end.

REQUIRED SUPPLEMENTAL INFORMATION

CITY OF GRAYLING
Required Supplemental Information
Defined Benefit Pension Plan
Trend Information
For the Year Ended June 30, 2005

Schedule of Funding Progress

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) - Entry Age (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
12/31/02	\$ 1,594,116	\$ 1,915,610	\$ 321,494	83.2%	\$ 614,162	52.4%
12/31/03	1,705,623	1,965,919	260,296	86.8%	582,557	44.7%
12/31/04	1,735,029	2,128,351	393,322	81.5%	593,426	66.3%

Schedule of Employer Contributions

Fiscal Year Ending	Annual Pension Cost (APC)	Percentage of APC Contributed
06/30/03	\$ 63,660	100%
06/30/04	64,676	100%
06/30/05	73,160	100%

See accompanying notes to the basic financial statements.

OTHER SUPPLEMENTAL INFORMATION

CITY OF GRAYLING
Combining Statement of Revenues, Expenditures, and Changes in Fund Balances
Nonmajor Governmental Funds
For the Year Ended June 30, 2005

	Debt Service
	<u> </u>
Revenues	<u>\$ -</u>
Expenditures	
Debt service:	
Interest	43,688
Principal retirement	<u>38,964</u>
	82,652
Total expenditures	<u> </u>
Excess (deficiency) of revenues over expenditures	<u>(82,652)</u>
Other financing sources (uses)	
Operating transfers in	<u>82,652</u>
Net change in fund balances	-
Fund balances - beginning	<u>-</u>
Fund balances - ending	<u><u>\$ -</u></u>

City of Grayling
Schedule of Bonded Indebtedness
June 30, 2005

	Date of Issue	Amount of Issue	Interest Rate	Due Date	Total		Semi-Annual Interest Payable
					Outstanding June 30, 2005		
General Obligation Limited Tax Bonds, Series 2003A	February 4, 2003	\$ 900,000	2.00%	8/1/2005	\$ 30,000	\$	18,005
			2.00%	2/1/2006			17,705
			2.20%	8/1/2006	30,000		17,705
			2.20%	2/1/2007			17,375
			2.60%	8/1/2007	30,000		17,375
			2.60%	2/1/2008			16,985
			3.05%	8/1/2008	35,000		16,985
			3.05%	2/1/2009			16,451
			3.40%	8/1/2009	35,000		16,451
			3.40%	2/1/2010			15,856
			3.75-5.00%	Thereafter	690,000		241,259
					<u>\$ 850,000</u>	<u>\$</u>	<u>412,152</u>

Call provision: Optional Prior Redemption: The bonds maturing on or before August 1, 2012 are not subject to redemption prior to maturity.

Bonds or portions of bonds in multiples of \$5,000 maturing on or after August 1, 2013 shall be subject to redemption without a premium, at the option of the City, in such order as the City shall determine and within any maturity by lot, on any interest payment date on or after August 1, 2012, at par and accrued interest to the date fixed for redemption.

City of Grayling
Schedule of Bonded Indebtedness
June 30, 2005

	Date of Issue	Amount of Issue	Interest Rate	Due Date	Total Outstanding June 30, 2005	Semi-Annual Interest Payable
Revenue Bonds:						
Water Supply and Sewage	June 28, 1991	\$ 1,140,000	5.00%	7/1/2005	\$ 19,000	\$ 24,175
Disposal System Junior				1/1/2006		23,700
Lien Revenue Bond,				7/1/2006	19,000	23,700
Series 1991A				1/1/2007		23,225
				7/1/2007	20,000	23,225
				1/1/2008		22,725
				7/1/2008	22,000	22,725
				1/1/2009		22,175
				7/1/2009	23,000	22,175
				1/1/2010		21,600
				Thereafter	864,000	531,600
					<u>\$ 967,000</u>	<u>\$ 761,025</u>

Call provision: Bonds shall be subject to redemption prior to maturity at the option of the City in inverse chronological order, on any interest payment date, at par and accrued interest to the date fixed for prepayment.

In addition, principal installments of this bond are subject to prepayment upon the request of R.E.C.D. (the bond holder) if at any time it should appear to R.E.C.D. that the City is able to refinance this bond by obtaining a loan for such purposes from responsible cooperative or private sources at reasonable rates and terms.

City of Grayling
Schedule of Bonded Indebtedness
June 30, 2005

	Date of Issue	Amount of Issue	Interest Rate	Due Date	Total		Semi-Annual Interest Payable
					Outstanding June 30, 2005		
Revenue Bonds:							
Water Supply and Sewage							
Disposal System Junior							
Lien Revenue Bond,							
Series 1991B							
	June 28, 1991	\$ 777,000	5.00%	7/1/2005	\$ 13,000	\$	16,475
				1/1/2006			16,150
				7/1/2006	13,000		16,150
				1/1/2007			15,825
				7/1/2007	14,000		15,825
				1/1/2008			15,475
				7/1/2008	15,000		15,475
				1/1/2009			15,100
				7/1/2009	15,000		15,100
				1/1/2010			14,725
				Thereafter	589,000		362,075
						\$	
					\$ 659,000	\$	518,375

Bonds shall be subject to redemption prior to maturity at the option of the City in inverse chronological order, on any interest payment date, at par and accrued interest to the date fixed for prepayment.

Call provision:

In addition, principal installments of this bond are subject to prepayment upon the request of R.E.C.D. (the bond holder) if at any time it should appear to R.E.C.D. that the City is able to refinance this bond by obtaining a loan for such purposes from responsible cooperative or private sources at reasonable rates and terms.

FEDERAL SINGLE AUDIT REPORTING



Hill • Schroderus & Co., LLP

Certified Public Accountants & Consultants

October 13, 2005

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

Honorable Mayor, Members of
City Council and City Manager
City of Grayling, Michigan

We have audited the financial statements of the governmental activities, business-type activities, each major fund and the aggregate remaining fund information of the City of Grayling, Michigan as of and for the year ended June 30, 2005, which collectively comprise the City of Grayling's basic financial statements and have issued our report thereon dated October 13, 2005. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the City of Grayling's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City of Grayling's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the audit committee, management and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Hill, Schroderus & Co.

CERTIFIED PUBLIC ACCOUNTANTS
Petoskey, Michigan



October 13, 2005

REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH
MAJOR PROGRAM AND INTERNAL CONTROL OVER COMPLIANCE IN
ACCORDANCE WITH OMB CIRCULAR A-133

Honorable Mayor, Members of
City Council and City Manager
City of Grayling, Michigan

Compliance

We have audited the compliance of the City of Grayling, with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) Circular A-133 *Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2005. The City of Grayling's major federal programs are identified in the summary of audit results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the City of Grayling's management. Our responsibility is to express an opinion on the City of Grayling's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the City of Grayling's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the City of Grayling's compliance with those requirements.

In our opinion, the City of Grayling complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2005.

Internal Control Over Compliance

The management of the City of Grayling is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered the City of Grayling's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on the internal control over compliance in accordance with OMB Circular A-133.

City of Grayling
Grayling, Michigan

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the audit committee, management and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Hill, Schroeder & Co.

CERTIFIED PUBLIC ACCOUNTANTS
Petoskey, Michigan

CITY OF GRAYLING
Schedule of Expenditures of Federal Awards
For the Year Ended June 30, 2005

Federal Grantor Pass-through Grantor Program Title	Federal CFDA Number	Federal Expenditures
U.S. Department of Homeland Security		
Direct Programs:		
Federal Emergency Management Agency:		
Assistance to Firefighters	83.554	\$ 56,992
Assistance to Firefighters	97.044	427,500
U.S. Department of Housing and Urban Development		
Pass-through programs from the State of Michigan:		
Community Development Block Grant/State's Program	14.228	192,392
Community Development Block Grant/State's Program	14.228	203,899
Environmental Protection Agency		
Pass-through program from the State of Michigan:		
Capitilization Grants for Clean Water State Revolving Funds	66.468	<u>3,125</u>
Total expenditures of Federal Awards		<u>\$ 883,908</u>

NOTE – BASIS OF PRESENTATION

The accompanying schedule of expenditures of federal awards includes the Federal grant activity of the City of Grayling and is presented on the modified accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of the basic financial statements.

**CITY OF GRAYLING
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
For the Year Ended June 30, 2005**

Finding/Noncompliance

There was no single audit in prior year.

CITY OF GRAYLING
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
For the Year Ended June 30, 2005

Summary of Audit Results

1. The City of Grayling has received an unqualified opinion on its financial statements.
2. We noted no matters in the City of Grayling's internal control structure which we considered to be reportable conditions.
3. We noted no noncompliance that would be material to the financial statements.
4. We noted no matters in the City of Grayling's internal control over its major programs, which we consider to be reportable conditions.
5. The City of Grayling has received an unqualified opinion on compliance for its major programs, Assistance to Firefighters (2) and Community Development Block Grant/State's Program (2).
6. We noted no audit findings required to be reported under Section 510 (a) of OMB Circular A-133.
7. The programs tested as major programs were Assistance to Firefighters and the Community Development Block Grant/State's Program.
8. The threshold used for distinguishing between Type A and B programs was \$300,000.
9. The City of Grayling did not qualify as a low-risk auditee.

Findings and Questions Costs

We noted no material findings, or questioned costs.